VZCZCXRO9675
PP RUEHIK RUEHLN RUEHPOD RUEHVK RUEHYG
DE RUEHKV #2105/01 2941531
ZNR UUUUU ZZH
P 201531Z OCT 08
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC PRIORITY 6573
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE

UNCLAS SECTION 01 OF 03 KYIV 002105

SENSITIVE
SIPDIS

DEPT FOR EUR/UMB, EEB/OMA
TREASURY PLEASE PASS TO TTORGERSON

E.O. 12958: N/A
TAGS: EFIN ECON ETRD PGOV XH UP
SUBJECT: UKRAINE'S BUSINESSES TENSE; IMF AND NSDC DELIBERATE

REF: A) KYIV 2097, B) KYIV 2030

SENSITIVE BUT UNCLASSIFIED, NOT FOR INTERNET DISTRIBUTION

¶1. (SBU) Summary. With ongoing International Monetary Fund (IMF) negotiations and an emergency session of the National Security and Defense Council (NSDC) as the backdrop, Ukraine's politicians swapped jabs, while businesses scrambled to cover their mounting losses. No announcement was made about a bailout plan, but the IMF released a press statement suggesting financial assistance may be offered regardless of snap parliamentary elections. Industry and banking leaders cite growing concerns about jobs, capital, and revenue losses. End Summary.

IMF Denies Tymoshenko's Claim

¶2. (SBU) The International Monetary Fund issued a press statement on October 17 denying it would require Ukraine to delay early parliamentary elections in return for a financial assistance package. Prime Minister Yulia Tymoshenko had announced earlier that the IMF would impose this conditionality (Ref A). Ukrainian press widely circulated the public clarification and response to Tymoshenko's claim. Separately, Tymoshenko met with IMF officials to discuss measures that would be conditional for financial support. She emerged from the talks to announce that she would end the negotiations successfully, and that Ukraine was likely to receive a large-scale (up to $14 billion) financial support package. Post received no confirmation from the IMF of Tymoshenko's claims by late October 20.

NSDC on the Financial Crisis

¶3. (SBU) Ukrainian President Viktor Yushchenko chaired a special meeting of the National Security and Defense Council on October 20 to consider a plan for stabilizing Ukraine's financial system. During his opening statement, Yushchenko implicitly bashed Tymoshenko, stating, "We should stick to professionalism, rather than political programs and political ideas." The president, who has referred to himself lately as a "categorical optimist," is expected to announce coordinated actions by the government and National Bank. Post had no independent report on the outcome of the meeting as of late October 20.

¶4. (SBU) Also on October 20, Yushchenko rejected a proposal to create an anti-crisis coalition in the Verkhovna Rada, made the previous evening in a nationally broadcast address by PM Tymoshenko. According to Yushchenko's press secretary, a coalition of this sort would be inferior to the NSDC in its "legitimacy, mobility, and professional merits." In her televised address, Tymoshenko again called for delaying the snap elections. She also announced the

suspension of her party's legal battle with Yushchenko over the elections, in favor of a proposal to create a grand coalition to address the financial crisis.

NBU Clarifies Resolution 319

¶5. (SBU) The National Bank of Ukraine (NBU) revised some of its previous measures on bank lending. Modifying its Resolution 319 of October 13 (Ref B), the NBU lifted the restriction that had prevented banks from expanding loan portfolios beyond their October 13 levels. Banks may now increase both hryvnia and foreign currency lending, but only to parties that export goods or services. In another welcome modification, importers can again purchase foreign currency to pay for imports before the goods arrive in Ukraine.

How Long Will Banks Support Subsidiaries?
-- ---------

¶6. (SBU) Roughly 70 percent of the external debt due by banks is owed by banks controlled by foreign banks (Ref A). Many local observers still assume that foreign parent banks will continue to supply their Ukrainian subsidiaries with short term funding. (Last week, for example, Raiffeisen Bank Austria gave its Ukrainian bank, Raiffeisen Aval, a $180 million short term loan.) Nonetheless, foreign bank representatives have told us that such backing is not without its limits. Hans Grisel, General Manager of ING Bank Ukraine, and Citibank's Nadir Shaikh said that measures adopted by regulators in the parent banks' home countries could compel them to reduce their exposure in particularly risky markets. In addition,

foreign banks could at some point themselves decide that the continued risk of operating a bank in Ukraine outweighs the value of the franchise, even in the longer run, particularly if Ukraine's credit rating worsens dramatically or the country places restrictions on the repatriation of earnings or capital. Currently, foreign banks are preparing a letter to the NBU requesting that they be allowed to hedge the capital that their owners had injected in their banks, Grisel and Shaikh told us. They will ask that the NBU allow them to maintain a foreign currency deposit with the central bank that equals the value of their paid-in capital at current exchange rates.

Crisis Hits Businesses and the Common Man
-- ---------

¶7. (SBU) We hear anecdotal information from a number of sources that business leaders (please protect throughout) and citizens alike are taking measures to soften the blow. Stephen Ansell, general manager of the Kyiv Hyatt, whose five-star hotel is owned by Ukrainian oligarch and head of the Industrial Union of Donbass (IUD) Sergey Taruta, told us that Taruta is extremely alarmed about his conglomerate's worsening economic position. Ansell said that Taruta's steel business is expecting heavy losses in the fourth quarter of 2008, during which time over 500,000 job losses are expected industry-wide. Echoing what Post heard from Rinat Akhmetov's System Capital Management (Ref A), Taruta told news weekly Kommersant that IUD would halt all investment projects, including a $500 million joint venture with Arcelor Mittal known as Crooked Horn. He also confirmed that 20,000 of IUD's 60,000 steel workers would be laid off. "It is not our fault," Taruta said. "We simply cannot support the pay of these people." IUD's vice president Oleksandr Pylypenko further stated, "This crisis is systemic. The problem concerns everyone. I think soon in Ukraine every third person will become jobless." For his part, Ansell lamented that his once thriving luxury restaurant business had also greatly suffered, due to inflation, currency devaluation, and rising food costs, but demand for Kyiv's limited high-end hotel rooms had shielded his core business from heavy losses.

¶8. (SBU) Automobile companies are expected to take similar measures to reduce their workforces. Bohdan Kulchyckyj, CEO of Winner Group

-- an American-owned importer and retailer of Ford, Volvo, Jaguar, Land Rover, and Porsche, is also dour about his company's prospects. Whereas sales growth had made the Ukrainian car market one of Europe's leaders for the past five years, there is now a huge inventory glut of mid-market and luxury cars. Kulchyckyj told us that banks halted new credit issuance for auto purchases on October 15, which has led to an immediate 50 percent drop in consumer demand and an expected sharp reduction in imports. Kulchyckyj has directed managers to rate all employees, protecting essential workers in the top 20 percent and letting go the bottom 10 percent. Kulchyckyj intimated this would be the first of at least two rounds of layoffs in the coming months.

¶9. (SBU) IKEA production executive Andreas Weidenholzer predicted large near-term layoffs in his industry. He lamented that IKEA's Ukraine-based furniture plant which, until six weeks ago, had been trying to secure investment for upgrades to its 20 year-old machinery, could halt production or shift operations to more efficient facilities in Romania. Weidenholzer cited market uncertainty, overly bureaucratic regulation, and a capital freeze as the basis for IKEA's move to EU plants. He was stinging in his appraisal of Ukraine's governmental response to the crisis, saying that officials are acting to get a return on their bribes before the impending elections throw them out of office.

¶10. (SBU) Although Kyiv-based analysts suggest that the hryvnia will depreciate further and that the NBU will be forced to move its official exchange rate downward, possibly in connection with an IMF conditionality that Ukraine allows the currency to float more freely, it is unclear where the hryvnia is actually headed or how fast a depreciation might occur. AmCham President Jorge Zukowski told us that several of his members, companies importing consumer goods, were preparing scenarios that foresaw an exchange rate anywhere between 7 and 10 UAH/$.

¶11. (SBU) Walking around the streets of Kyiv, concerns about the exchange rate are visible on the faces of everyday citizens. EconOff stood in line at a local exchange kiosk, where twenty people waited to sell hryvnia at one of the city's best advertised prices, which at 5.35 to 5.50 UAH/$ on October 20 was weaker than the NBU's official rate of 4.96 (+/- 8 percent). Elderly ladies expressed their belief that the currency would only further devalue. Others in the queue, from men in business suits to construction workers, whispered that they needed to buy now "before dollars were all

gone."

TAYLOR